

THE ECONOMICS OF ADVERTISING

by 544

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## INTRODUCTION

"One should hardly have to tell academicians that information is a valuable economic resource: knowledge is power. And yet it occupies a slum dwelling in the town of economics. Mostly it is ignored: the best technology is assumed to be known; the relationship of commodities to consumer preferences is a datum. And one of the information producing industries, advertising, is treated with a hostility that economists normally reserve for tariffs or monopolists."<sup>1</sup>

Where economists have chosen to treat advertising at all the conclusions have not been wholly complimentary. Neither are economists alone in the attack on Madison Avenue and the advertising fraternity for which Madison Avenue is the symbol. Civil rights groups have picketed the Benton and Bowles advertising agency and demanded that money be diverted from advertising into education in slum areas. Consumer groups have boycotted supermarkets charging that advertising and promotional gimmicks have increased food costs. Arnold Toynbee, quoted in Printers' Ink magazine, has said, "The destiny of our American civilization turns on the issue of our struggle with all that Madison Avenue stands for more than it turns on the issue of our struggle with Communism. Producing and disposing of the maximum quantity of consumer goods was not the purpose of the American Revolution. What is more, it is not the true end of man."<sup>2</sup>

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<sup>1</sup>George Stigler, "Economics of Information," Journal of Political Economy, LXIX (June, 1961) 213-225.

<sup>2</sup>Printers' Ink, "Advertising: Today, Yesterday, Tomorrow," CCLXXXIII (July 14, 1963).

Vilification of the advertising industry has become something of a national pastime. The industry bearing the brunt of the condemnation is related, though not identical, to publicity, public relations, sales promotion, personal selling and propaganda. Neil Borden, author of perhaps the most extensive scholarly works dealing with advertising, defines advertising as "those activities by which visual or oral messages are addressed to the public for the purposes of informing them and influencing them either to buy merchandise or services or to act or be inclined favorably toward ideas, institutions, or persons featured."<sup>3</sup> Implicit in Borden's definition is identification of the messages with the advertisers and the elements of commercial transactions involving pay.

It is the fact of payment for advertising and the relative enormity of the national advertising bill which perhaps gives rise to much of the popular concern over advertising. In 1966 American advertisers spent in excess of \$16 billion.<sup>4</sup> Nearly two per cent of the Gross National Product, an amount equal to one third the total national bill for education or two thirds of the national bill for the Vietnam conflict, in 1966 was accounted for by advertising.<sup>5</sup> The relative magnitude of advertising in the economy makes it a relevant area of concern for economists.

Economists are being looked to to supply answers to basic questions about advertising. Does it enhance the social welfare? Does it operate to

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<sup>3</sup>Neil Borden, The Economic Effects of Advertising (Chicago: R.D. Irwin, 1942) 17.

<sup>4</sup>Charles K. Raymond, "Will the Dismal Science Study the Happy Art?" Journal of Advertising Research, VII, No. 2 (June, 1967) 58,59.

<sup>5</sup>Americana Annual, 1967, 250.

increase or decrease the national income? Does it make prices rigid and unresponsive to changes in economic conditions? Is its net effect to raise or lower consumer prices? Does it increase or restrict freedom of consumer choice?

These are pertinent questions to which there are no ready answers. Attempts are being made to supply answers, but this has not long been the case.

#### HISTORY OF THEORETICAL TREATMENT OF ADVERTISING AND SELLING COSTS

The genesis of systematic economic analysis took place, with Adam Smith's Wealth of Nations, in an environment of barter economy devoid of manufacturing industry, dominated by local markets and characterized by face to face sales transactions. Selling costs were negligible, advertising was non-existent and no theoretical economic framework need have included them to be relevant to the then contemporary economy. "In classical economic theory advertising has little justifiable place. Most of it was regarded as waste of resources."<sup>6</sup>

The onrush of the industrial revolution, of which Smith and his contemporaries witnessed only the beginnings, wrought profound changes in the economic structure of the Western world. The rise of industrial manufacturing reshaped the market structure. A decline in barter economy was matched by surges in larger centralized markets, monetary system development and demographic mobility. The face to face nature of trade was replaced by systems of intermediaries and anonymity between producer and consumer. Specialization and division of labor resulted in greater uniformity within categories of products. As producers and consumers became detached from direct contact, trade marks became symbols

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<sup>6</sup>Edward A. Lever, Advertising and Economic Theory (London: Oxford University Press, 1947) ix.

of identification to consumers. The approach to selling changed with the approach to producing. The new emphasis was upon massness. Advertising was born.<sup>7</sup>

Borden contends that too little credit for economic growth has been attributed to demand factors. Economic historians have attributed growth during the industrial revolution almost solely to supply rather than demand factors, i.e. to power, technology, managerial skill and specialization.<sup>8</sup> But during the same period, Borden says, changes in society--maturing individual freedoms, greater mobility, urbanization and aggressive selling--contributed to the growth of demand which as much as growth of supply was instrumental in enlarging national incomes.<sup>9</sup> Pure competition as construed by the classicalists, if it had ever existed, was a thing of the past.

But theoretical treatment of an economic system of which advertising is a functional, if not itself monetarily significant element, was a long time coming. Alfred Marshall's Principles of Economics, first published in 1890, and his Industry and Trade, 1919, represent probably the first major assault on classical theory in favor of industry by industry analysis more descriptive of reality. Marshall's neo-classical view of advertising, though neither exhaustive or systematic, is unique in its time for its very expression. "Exceptionally constructive are all those measures needed for explaining to people generally the claims of some new thing, which is capable of supplying a great but latent want. But eager rivalry often causes them to be carried to an excess, which involves social waste; and ultimately tends to raise the charges which the public has to meet without adequate return."<sup>10</sup>

<sup>7</sup>Borden, Advertising in Our Economy (Chicago: R.D. Irwin, 1949) 26.

<sup>8</sup>Ibid. 261.

<sup>9</sup>Ibid. 264.

<sup>10</sup>Alfred Marshall, Industry and Trade (London: MacMillan Co., 1923) 305.

"Of course, no amount of expenditure on advertising will enable anything, which the customers can fairly test for themselves by experience, to get a permanent hold on the people, unless it is fairly good relative to its price. The chief influence on such advertisement is exerted, not through reason, but through the blind force of habit; people in general are, for good or for evil, inclined to prefer that which is familiar to that which is not."<sup>11</sup> In a more rigorous vein Marshall enumerates his conclusions concerning the social waste of advertising. "The lavish advertiser must deduct his expenses from the gross profits of his additional sales; while rivals whom he ousts lose their gross profits, and thus there enters one element of social waste. It is true that his additional sales may slightly lower his costs of production per unit; but in fact nearly all the products, in the advertisement of which iteration has been carried to extravagant excess, offer occupation for many firms, each strong enough to command the chief economies of large scale production. A second element of social waste caused by bold displayed advertisements, is the relative obscurity into which they are designed to throw, and do throw, the smaller advertisements of less wealthy men; some of whom may have high constructive faculty."<sup>12</sup>

In a statement prophetic of impending theoretical groundwork in economics and subjective in its implications Marshall says, "The fiercest and cruellest forms of competition are found in markets which are no longer quite free, but have already been brought in some measure under monopolistic control."<sup>13</sup>

<sup>11</sup>Ibid.

<sup>12</sup>Ibid. 306, 307.

<sup>13</sup>Ibid. 396, 397.

The inadequacies of pure competition theory, which aroused the neo-classicists to construct modifications of the theory, gave birth to a new genre of analysis addressing itself to reality and thus to impure forms of competition. "Conventional demand theory starts from the proposition that there are given consumer tastes, incomes, a set of goods, and prices at which unlimited purchases can be made by individual consumers. This is a useful model for many purposes, but it does not go far toward explaining advertising's role."<sup>14</sup>

"Pure competition was irreconcilable with increasing returns, with control over price, with advertising, etc....Now there arose a theory in which all these facts found their place, and were systematically integrated into the analysis of value phenomena."<sup>15</sup> The theory, or theories, of which Triffin speaks were rigorously presented in 1933 in Joan Robinson's The Economics of Imperfect Competition<sup>16</sup> and in E.H. Chamberlin's The Theory of Monopolistic Competition.<sup>17</sup> Robinson and Chamberlin deal almost exclusively with analysis on the firm or company level to the exclusion of macroeconomic considerations. Monopolistic competition analysis in its closer proximity to reality is characterized by differentiation of product and package as a basis for consumer preference, alternative forms of competition in lieu of price competition (e.g. advertising), tendency toward concentration of supply in a small number of large concerns, and the potential for suppliers to utilize their monopolistic position (brand loyalty) to raise prices.<sup>18</sup>

<sup>14</sup>L.G. Telser, "Supply and Demand for Advertising Messages," American Economic Review, LVI (May, 1966) 462.

<sup>15</sup>Robert Triffin, Monopolistic Competition and General Equilibrium Theory (Cambridge: Harvard University Press, 1940) 17.

<sup>16</sup>London: Macmillan Co.

<sup>17</sup>Cambridge: Harvard University Press.

<sup>18</sup>Borden, Advertising in Our Economy, 42.



While Robinson makes only four references to advertising's effects in an analytical model describing a system in which advertising is, if not a causative, at least a prominent collateral factor, Chamberlin devotes two of nine chapters to a treatment of the effects of selling costs. As a departure from classical theory monopolistic competition theory is significant to an analysis of advertising and the national economy because it recognizes the existence of advertising and accords it an integral position in the model. Chamberlin emphasizes the failure of classical economics to deal with costs of selling. "Theoretical economics continues to regard him (the producer) as producer only, and as enjoying a demand which is already there and which has cost nothing."<sup>19</sup> But the newer theory deals primarily with costs to the producer and neglects to treat costs, both economic and social, to the consumer which demand manipulation engenders.

#### MACROECONOMIC EFFECTS OF ADVERTISING

While Robinson, Chamberlin and other lesser economic luminaries have dealt rigorously and at length with monopolistic competition, advertising and how their presence and utilization affect the producer, no such systematic analysis has yet been penned to explain or describe the effects of advertising relevant to the consumer, to the national income and to the social welfare. John Maynard Keynes, in General Theory, 1936, was among the first to place relative importance on consumption as a process.<sup>20</sup> His analysis, however, does not encompass the role of advertising and its influence on the scale of consumption. Defenders of advertising are legion among those whose livelihood depends on it and moderately rare among those whose objective is analysis.

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<sup>19</sup>Edward Chamberlin, Theory of Monopolistic Competition, 127.

<sup>20</sup>Lever, 3.

Among published economists, the predominant reaction to the question of advertising is silence. The authors of five of the most widely used introductory economic texts, Samuelson, McConnell, Bach, Reynolds and Harries, collectively devote less than a score of paragraphs to the industry, which accounts for over two per cent of the United States' gross national product.<sup>21</sup> While economists agree on the desirability of more complete consumer information concerning the market, they resist the impulse to systematically analyze the chief purveyor of market information, the advertising industry, from the perspective of the consumer. The relative merits of advertising in the role of suppressing ignorance in the economy are ignored.

"Ignorance," writes Stigler, "is like subzero weather; by a sufficient expenditure its effects upon people can be kept within tolerable, even comfortable bounds, but it would be wholly uneconomics entirely to eliminate all its effects. And, just as an analysis of a man's shelter and apparel would be somewhat incomplete if cold weather is ignored, so also our understanding of economic life will be incomplete if we do not systematically take account of the cold winds of ignorance."<sup>22</sup>

The question of advertising encompasses ethical as well as economic issues. Social costs and social benefits derived from advertising are impossible to isolate and therefore difficult to quantify. This difficulty leaves for the economic analyst only educated speculation as to the precise nature of advertising's niche in the cause and effect dynamics of the economic system. The ethical issues, while not divorced from the economic issues, lend themselves more easily to discussion in part because of the very nature of

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<sup>21</sup>Raymond, 58,59.

<sup>22</sup>Stigler, "Economics of Information," 224.

advertising. The objectives of advertising are obvious; its methods are visible, its manifestations are overt. Because to succeed, advertising must reach people, people are aware of those of its characteristics which front on ethical issues. In short, the means of advertising fall generally within the category of ethical controversy, its ends in the economic.

"Naturally, most of the thought of the advertising world is devoted to the technical problem of securing results, and broad economic and ethical considerations are very largely ignored."<sup>23</sup> Assaults on the ethics of advertising are characteristically passed off by its defenders as irrelevant. To the charge that advertising induces consumers to purchase goods which they don't need, the rebuttal is predictable. "All people really need," it is said, "is a cave, a piece of meat, fire, a 1928 Essex for transportation, and one simple dress for clothing."<sup>24</sup> If marketers and producers catered only to needs, not to wants or desires, they would be selling tents instead of ranchhouses, skins instead of fashions.<sup>25</sup> "Most advertised products in modern nations are not necessities of life but are wanted as a result of culturally-imposed values, and advertising helps to mold these values."<sup>26</sup> The issue of wants versus needs leads to debate over planned obsolescence and built-in depreciation, which critics claim are prodigies of Madison Avenue.

<sup>23</sup>Ralph Borsodi, National Advertising and Prosperity (New York: Arcadia Press, 1923) 12.

<sup>24</sup>Stewart Britt, The Spenders (New York: McGraw-Hill, 1950) 42.

<sup>25</sup>Samuel Dunn, Advertising: Its Role in Modern Marketing (New York: Holt, Rinehart, and Winston, 1961) 85.

<sup>26</sup>Otis Pease, The Responsibilities of Advertising (New Haven: Yale University Press, 1958) 22.

Changing products and the resultant surges in advertising expenditures, claims Telser, are as much the result of the needs of the advertising industry as the result of the needs of the consuming public.<sup>27</sup> Planned obsolescence is neither the creation nor the design of the advertising industry, one defender suggests, but is the result of the American mentality which equates "newer" with "better." The industry merely takes this fact and uses it, sells goods with it.<sup>28</sup> Galbraith, perhaps suitably labeled a moral economist, takes up the attack on the ethics of advertising. Advertising and aggressive salesmanship "cannot be reconciled with the notion of independently determined desires, for their central function is to create desires--to bring into being wants that previously did not exist."<sup>29</sup> ...Is a new breakfast cereal or detergent so much wanted if so much must be spent to compel in the consumer the sense of want?...<sup>30</sup> The fact that wants can be synthesized by advertising, catalyzed by salesmanship, and shaped by the discreet manipulations of the persuaders shows they are not very urgent. A man who is hungry never need be told of his need for food."<sup>31</sup> Advertising is effective, Galbraith contends, only with those who do not already know what they want. "In this state alone men are open to persuasion."<sup>32</sup>

"Outlays for the manufacturing of a product are not more important in the strategy of modern business enterprise than outlays for the manufacturing of a demand for the product,"<sup>33</sup> claims Galbraith.

<sup>27</sup>L.G. Telser, "How Much Does It Pay Whom To Advertise?" American Economic Review, LI (May, 1961) 234.

<sup>28</sup>Martin Mayers, "Myths of Advertising," The Promise of Advertising, Charles Sandage, ed. (Homewood, Ill.: R.D. Irwin, 1962) 162.

<sup>29</sup>John K. Galbraith, The Affluent Society (Boston: Houghton Mifflin, 1958) 155.

<sup>30</sup>Ibid. 156.

<sup>31</sup>Ibid. 158.

<sup>32</sup>Ibid.

<sup>33</sup>Ibid. 156.

But the answer from the industry remains what it has always been. "The question is not whether advertising attempts to cause people to buy things they don't need, but rather if the attempt is successful."<sup>34</sup>

Granting that the attempt is not wholly unsuccessful, the consequences of enormous outlays for advertising pose questions significant for economic discussion. Do the demand effects of advertising allow for increased efficiency of production by lowering unit costs or would demand sans advertising be sufficient to generate economies of scale diminished by less than the costs of advertising? Does advertising contribute to a quality upgrading tendency by producers or does it allow them to foist on the consumer products which are not "better" but only blessed by a brand name and an advertising campaign? Does it result in meaningless product differentiation or does differentiation necessitate advertising? Does it increase the general level of output by stimulating activity or does it function to drain resources which could otherwise be utilized for materially productive activity?

Is its effect countercyclical and stabilizing or does advertising elevate peaks and depress troughs in the level of economic activity? Does advertising increase consumer satisfaction by contributing a measure of utility of its own or is it a subsidized commodity the value of which cannot be put to the market test? Does it promote or preclude a functional free press? Is freedom of choice for the consumer enveloped or enhanced by advertising?

Due to the impossibility of isolating and divorcing the effects of advertising from other variables within the economic framework, attempts to answer these questions must be analytical rather than empirical in approach. We turn now to broaching in turn each of the foregoing issues and endeavor to present competing points of view in each case.

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<sup>34</sup>Dunn, 85.

Perhaps the pivotal issue concerning advertising is its effect on prices. Advertising and aggressive selling, its defenders claim, may perform for business the economic function of conformities of demand needed for large scale production, thereby actually reducing prices in an economy characterized by increasing returns to scale.<sup>35</sup> This proposition rests upon a concept of expansible demand whereby a business can increase demand readily, while maintaining constant selling prices, through appeal to consumers' buying motives.<sup>36</sup> Appeal to buying motivations may take two forms, primary and selective. Primary advertising stresses utility of a class of product and serves to expand total consumption. It tends to strengthen an industry and all firms therein and does not seek merely to affect a redistribution of shares within an industry. Selective advertising, on the other hand, emphasizes differentiation within a class of product and does not contribute to expansion of total demand.<sup>36</sup> Though Borden labels primary advertising the more economically desirable he concedes that a major share of advertising in a monopolistic competitive market such as the United States is employed more to secure, for the advertised product, a larger share of the consumer's expenditures for that class of product than would be the case without advertising.<sup>37</sup>

Primary advertising is profitable only "if the selling firm has some monopoly power, for example, if it is large enough relative to the total supply so that it benefits from increases in total demand."<sup>38</sup> The most economically beneficial form of advertising, one may conclude, is profitable for and will be utilized by those producers who in some measure possess monopolistic powers.

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<sup>35</sup>Borden, Economic Effects, 170.    <sup>36</sup>Ibid. 165.    <sup>37</sup>Ibid. 167.

<sup>38</sup>L.G. Telser, "Advertising and Competition," Journal of Political Economy, LXXII (December, 1964) 541.

The virtue of primary advertising is its effect upon demand for a class of product rather than a single product. Primary advertising thus avoids mere redistribution of consumption expenditures among a given class of product but seeks to expand demand for the whole class at the expense of other classes. If more is spent on automobiles, for example, correspondingly less will be spent for food or clothing or entertainment--unless advertising can expand total demand across the whole spectrum of product classes. "It is sometimes claimed that advertising creates demand. This is not an exact statement. Demand results from the effort to satisfy a want, together with a willingness and an ability to spend the money required. Advertising can create a want, and even influence the willingness to pay, but it cannot directly produce the ability to spend."<sup>39</sup> The effect of market information, dispersed through the advertising medium, however, may effect savings which free resources which do contribute to the ability to spend.

Advertising is said to induce savings in production costs through economies of scale, but perhaps more importantly the savings may be realized in reduction in total costs of supply (production and marketing costs) which result in lower prices and thus higher levels of consumption on a given national income. The market information effect of advertising contributes, claims M.I. Goldman, to reduction in marketing costs by making possible wider utilization of self-service techniques and reductions in the size of direct sales forces by educating the consumer to act for himself. Savings are thus affected when the consumer knows what is available, what is wanted, where to look for it and how it will be packaged. Intangible savings, too, accrue to the consumer who then needs spend less time in the commercial activities of consumption.<sup>40</sup>

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<sup>39</sup>Lever, 49.

<sup>40</sup>M.I. Goldman, "Product Differentiation and Advertising," Journal of Political Economy, LXVIII (August, 1960) 354.



The logical ensuing question pertains to the fitness of the institution of advertising in its present form to perform the market information function. The alternatives to advertising in this role are difficult to assess though several have made the attempt.

George Hotchkiss writes, "If we did not pay this amount out for advertising we should pay out all or most of it for other items of production and marketing expense. Part would go for higher costs of production due to smaller scale enterprises. Part would go for added costs of personal salesmanship by manufacturers, jobbers and dealers. Part would go for increased time and effort by buyers. Part would go for greater losses through unsatisfactory goods and substitutes by unscrupulous dealers. Very likely these and other added costs would more than compensate for the cost of advertising..."

"I hope that sometime these manufacturers may come out boldly and say: 'of the dollar you paid...five per cent represents the cost of educating you. You were entitled to know about the article, and advertising was the cheapest, surest and most economical way of informing you...'

"I believe the time will come when people will generally understand this condition. This will be when they recognize that the giving of information about goods and services is a service that somehow must be performed and must be paid for. If there is a better way of performing it than advertising, it has yet to be found. I hope this principle (the alternative to advertising) will be enunciated and fully developed in that future text which some economist is going to write and bring to the attention of a hundred thousand American citizens through the use of advertising."<sup>41</sup>

The mass approach taken by advertising in distributing information necessitates a concentration upon broad appeal and allows for little

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<sup>41</sup>George Hotchkiss, "An Economic Defence of Advertising," American Economic Review, XV (March, 1925) 21,22.



tailoring to specific desires of individual consumers. The lack of definitive comparative information contained in advertisements might be overcome by advertisers, Telser contends, if denunciation of rivals in addition to self-praise was practiced. This would increase total knowledge of the market by the consumer because conflicting claims might reveal more truth. But the savings to society from more perfect knowledge thus attained might be offset by the additional costs of the judicial system from increases in numbers of libel and damage suits.<sup>42</sup>

In a less facetious tone Telser ponders the consequences of selling advertising as separate commodity much as one might sell a left shoe separately from a right shoe. Telser says that under such circumstances, the transaction costs of doing business would be multiplied. The alternatives to selling advertising under the same cover with the product at a single price as is now done would eliminate the element of subterfuge but might involve greater costs to the consumer. The cost of administering pay television might well exceed the revenue derived and would certainly cost more than the expense now involved in transacting payment from advertisers for commercial sponsorship.<sup>43</sup>

The suggestion that advertising be marketed separately stems from a feeling that there exists wasteful excess supply of advertising which would be wiped out if it were subject to ultimate market testing. Nicholas Kaldor thinks the question of waste must be answered by reference to the presumed social utility of the service which advertising provides. One must ask if there is a genuine need for it, if it fulfills this need satisfactorily and if the scale of expenditure on it is excessive. Although Kaldor answers affirmatively in all three cases, the issue of excessive expenditure and resulting

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<sup>42</sup>Telser, "Supply and Demand," 461. <sup>43</sup>Ibid. 458.

waste incurred when advertising's contribution to costs are concealed is not so easily dismissed.

Telser outlines the waste argument in more analytical terms.

"The amount of advertising supplied is excessive relative to the demand because in most cases advertising is provided at a zero price to potential buyers while the cost of advertising is positive to society. Since advertising employs scarce economic resources, one would think that the suppliers of advertising would prefer to sell it at a positive price if they could. However, advertisers may believe that the amount of advertising that would be demanded at a positive price is less than the amount they should provide to maximize their profits. The advertising expense is borne by the consumers, who pay a higher price for the advertised goods. In addition, since most advertising is not supplied at a positive price separately from the goods and services being advertised, it is concluded that buyers have more advertising foisted off on them than they would be willing to purchase in a separate market for advertising services. This implies a departure from marginal cost pricing and a consequent waste of resources."<sup>44</sup>

In rebuttal Telser says there is not an excess supply of carburetors because they come "free" on cars. Economies of scale may justify joint goods sales--if every man could specify exactly how many horsepower he desired for his automobile, there would be no excess supply of horsepower but no economies of scale either.<sup>45</sup>

To analyze a separate market for advertising messages Telser introduces a graphic presentation, Fig. 2. The vertical scale represents price per message and the horizontal quantity of advertising messages. AC is

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<sup>44</sup>Telser, "Supply and Demand," 457.    <sup>45</sup>Ibid. 457.

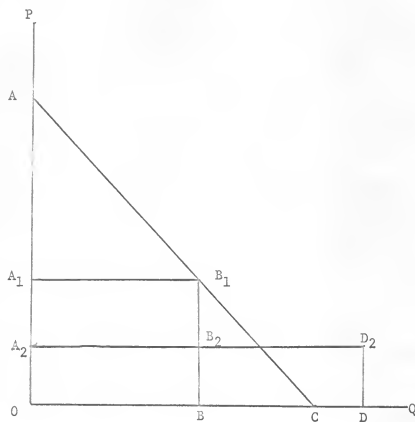


Fig. 1: Market for advertising messages.

demand for advertising messages,  $A_1B_1$  is the supply (assumed to be perfectly inelastic) of advertising messages if sold separately,  $OA_2$  is the cost per message other than transaction costs,  $A_2A_1$  represents the transaction cost of selling advertising separately spread across the number of messages.  $OB$  is the quantity of advertising messages supplied at equilibrium if sold separately, and the area of rectangle  $OBB_1A_1$  represents resources engaged in advertising if sold separately.

When advertising is sold separately to consumers at the point of sale for the advertised product, much as if soles were sold separately but in conjunction with shoes, additional time and expense (transaction costs) accrue to the supplier which will be passed on to the consumer. If, however, advertising is sold jointly with the product in a single undifferentiable transaction the added transaction costs (rectangle  $A_1B_1B_2A_2$ ) are eliminated. Thus in a market of joint sales the resources involved in added transaction costs can be utilized in providing a greater quantity of advertising for which the total cost per message is now reduced, with all the claimed economic advantages that implies. If the areas of rectangles  $A_1B_1B_2A_2$  and  $BDD_2B_2$  are equal any quantity of advertising messages supplied in the  $BD$  range will involve more messages with less resources used than would be the case if separate markets pertained.<sup>46</sup>

While Telser's analysis may be theoretically correct his conclusion that the economies of joint sales justify a form of excess supply of advertising are open to question. Peter Steiner in discussion of Telser's model describes waste in advertising as a function of demand for advertising. Because producers produce to the point of total profit maximization within

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<sup>46</sup>Ibid. 459, 460.

the framework of monopolistic competition, a portion of advertising is purely defensive or designed merely to compete with advertising sponsored by competitors. Given the built-in upward bias in advertising expenditures to offset competing advertisements and thereby to maximize profits, producers as intermediate purchasers of advertising messages demand more advertising than would the ultimate consumers who must in the end pay for it. Graphically Steiner uses Telser's quadrant with quantity of advertising on the horizontal axis and price on the vertical, Fig. 2.  $D_s$  is the sellers' demand curve for advertising based on the sellers' view of the amount of advertising which will maximize profits.  $D_c$  is the consumer's demand curve for advertising based on what he is willing to pay. Since the sellers' demand curve intersects the advertising supply curve to the right of the consumers' demand curve intersection more advertising will be bought by sellers and paid for by consumers than would be the case if consumers could make their own advertising decisions directly. In Steiner's view  $q_1q_3$  represents the relevant excess demand for advertising and subsequent excess cost to consumers and social waste.<sup>47</sup>

Borden views such analysis with skepticism. He suggests that a latter day subscription to the full employment assumption "influences the conclusions of those who, apparently believing that only a minimum of advertising for informational purposes is necessary, reason that heavy competition in advertising is unfortunate economically because it may result in much of the national dividend being devoted merely to the building of product reputation. These people conclude that it would be desirable to divert men engaged in persuasive advertising into manufacturing work or into services

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<sup>47</sup>Peter Steiner, "Discussion," American Economic Review, LVI (May, 1966) 473.

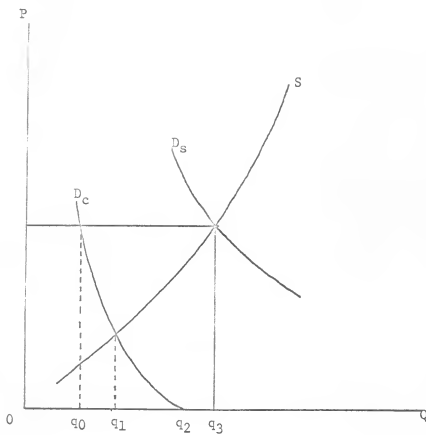


Fig. 2: Market for advertising messages.

which they deem desirable from a consumption standpoint. They point out that with such diversion to manufacturing, the amount of goods and services available for consumption, other than persuasive advertising services, would be increased, because, according to the assumption of full employment, men and resources not employed for advertising would be employed in other endeavor."<sup>48</sup>

While Borden may justly doubt the validity of a full employment assumption the implied alternative, that resources thus freed from advertising would sit idle, is no less shaky. It may be considered that the resources and manpower utilized in advertising, in excess of the informationally required minimum, are not more useful from a production point of view than if they remained idle. To expend resources superfluously simply to prevent them from becoming physically idle is reminiscent of Aldous Huxley's allusion in Brave New World to an economy in which all games must be designed to utilize a maximum of equipment and be indulged in at great distance from population centers so that jobs for equipment makers and transport workers may be created and maintained.

Turning from the demand effects of advertising in terms of pricing and scalar economies to the effects of advertising on product quality we encounter an issue for which contemporary examples are available. The American experience and the Soviet experience offer objects for comparative analysis of the effect of advertising on quality. We draw heavily on Goldman's discussion of the Soviet experience in this area.

In contrast to the United States the Soviet economy is characterized by sellers' market conditions and product homogeneity. While the absence, until recently, of advertising in the Soviet Union has been only one of many

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<sup>48</sup>Borden, Economic Effects, 185.

basic differences in the workings of the economy, Goldman suggests that in the area of quality control advertising, or the lack of it, is a telling difference. The Soviet system of administrative incentives and controls concentrated upon quantity rather than quality has aggravated the Soviet quality dilemma.<sup>49</sup>

In the absence of a competitive situation wherein no advertising and no competitive bias in favor of upgrading quality exists the Soviets have attacked sagging product quality with standards of administratively imposed quality control. Grading eggs or meat is relatively simple and is done in the United States, but the formulation, policing, and administering of quality controls on more complex products has generated costs which may well surpass the costs which differentiation, advertising and aggressive selling would impose.<sup>50</sup> In addition to imposed standards the Soviets have indulged in a type of product differentiation based on production marking as an instrument of quality control. This intentional differentiation is achieved by requiring each state firm to adopt a name and to brand its products with production mark identifying the maker. Even in the absence of competition for the producer as we know it, shoddy merchandise is thereby readily identifiable as to maker and he is more directly subject to administrative action. Production marking is also said to assist the worker in identifying with his product and inducing him to take a measure of pride in his craftsmanship.<sup>51</sup> A Soviet market economist contends that "Due to its originality the trade mark makes it possible for the consumer to select the good which he likes, the one which is produced by one firm, out of a number of homogeneous goods made by other firms. This forces other firms to undertake measures to improve the quality of their own product

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<sup>49</sup>Goldman, 349.

<sup>50</sup>Ibid. 352.

<sup>51</sup>Ibid. 349,350.



in harmony with the demands of the consumer. Thus the trade mark promotes the drive for raising the quality of production."<sup>52</sup>

Capitalizing on the trade or production marking procedure, the Soviets have increasingly utilized billboards, posters, handbills, even radio and television commercials to induce consumers to purchase selectively and to choose the goods of this state firm or that. The state monopoly, however, is able to use advertising in this manner and still avoid the gadgetry and over saturation characteristic in the United States. Testimony to the newfound Soviet conviction that advertising combined with trade marking can improve quality is found in the existence of state advertising agencies and an advertising journal, in the calling of an All Socialist Advertising Conference in Prague in 1957 and an All Union Soviet Advertising Conference in Moscow in 1958, in periodic state sponsored advertising contests for attractive display and layout.<sup>53</sup>

The Soviets have tested and rejected a marketing system which utilized neither differentiation nor advertising while Western welfare economists, having never had to face squarely the quality control problem, have been prone to assume that managers in the new system of undifferentiated products which they envision will altruistically follow the rules.<sup>54</sup> Goldman concludes that western economists tend to take product quality for granted--an assumption which the Soviet experience casts in doubt, they play down the role of advertising in promoting general quality consciousness, they fail to recognize that administration and inspection costs may make total cost less for advertised differentiated products than for unadvertised homogeneous products.<sup>55</sup>

While maintenance of quality for a brand does not depend upon advertising, advertising usually intensifies the desire of a manufacturer to maintain

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<sup>52</sup>Ibid. 351. <sup>53</sup>Ibid. 355. <sup>54</sup>Ibid. 353. <sup>55</sup>Ibid. 356.

quality in order to protect the goodwill which adheres to his brand.<sup>56</sup>...The sum of small differences produced by research of competitive organizations has resulted in product progress which leads to increased satisfaction in consumption."<sup>57</sup> Product differentiation and product quality are relevant to each other and both are relevant to advertising. The precise nature of the inter-relationship is unclear and merits exploration.

The billions spent on advertising might be of greater use to society if spent on production, it is charged, rather than on the seemingly unproductive function of advertising, especially when apparent advantages of one product over another are artificially created by advertising. This meaningless differentiation precludes producers from producing at the optimum social level.

"Striving for 'selling points' has encouraged some meaningless product differentiation and developed scales of values in consumers' minds which tend to divert expenditure to advertised products from more socially desirable products."<sup>58</sup> Perhaps the veracity of the charge of meaningless differentiation can best be weighed in the light of advertising's own evaluation of its role in this area. One advertising firm in a spread describing its unique service to producers said "Though on the surface your product and competing ones may be as like as two peas, yet there is a way to make your product stand out from all the rest. In your product or in its use, just as in you yourself, there is genuine individuality. This lies, not in any superficial differences that others may match next year, not in any trick presentation, but in the creation of a unique and distinctive personality that belongs to you,

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<sup>56</sup>Borden, Economic Effects, 632.    <sup>57</sup>Ibid. 625.    <sup>58</sup>Lever, 9.

alone."<sup>59</sup> While the creation of a distinctive and unique personality for a given producer's product may be a technical possibility, personality for products, at least in terms of economically measurable social benefits, hardly escapes the category of meaningless differentiation.

A cause and effect controversy, not unlike the proverbial "hen or egg first?" issue, surrounds the relationship between advertising and product differentiation. Insolubility, however, does not preclude discussion of issues and this issue is no exception. Samuel Dunn says that advertising tends to decrease rather than increase conformity. It thrives on differentiation. Consumers are urged to explore various ways of indulging various tastes. The marketing revolution has been so successful that the consumer is now so prosperous as to be unsatisfied with his mass-produced car—it must embody a certain color, shape, size and personality.<sup>60</sup> Taking the opposite view in an earlier day (1903) John Powers has said, "Extensive advertising results in standardizing an article. People become familiar with its special features and they are willing to pay for them."<sup>61</sup> Whether advertising's effect is toward product conformity or diversity, is a moot question to Telser, who assumes periodic availability of new and different products. "The demand for new products," he says, "contains a derivative demand for the various means of promotion, including advertising."<sup>62</sup> Thus in Telser's view differentiation is the cause and advertising is the effect. But differentiation, whether causing or caused

<sup>59</sup>Willard Cochrane and Carolyn Shaw Bell, The Economics of Consumption (New York: McGraw-Hill, 1956) 376,377.

<sup>60</sup>Dunn, 84.

<sup>61</sup>John Powers, "Advertising," Annals of the American Academy of Political and Social Science, XXII (1903) 470-474.

<sup>62</sup>Telser, "Supply and Demand," 464.

by advertising, whether meaningless or otherwise, involves obvious costs and equally obvious benefits. The relevant issue then is the opportunity cost to society of differentiation--and advertising--as opposed to homogeneity.

Waste occurs, it is said, through production inefficiency when scores of companies produce and advertise only slightly altered versions of the same product and when tooling costs are incurred simply to produce a newer model of the same product. In order to eliminate waste, welfare economists argue that a reduction or elimination of product differentiation would permit an increase in production efficiency. Again, drawing on the Soviet experience, it is Goldman's contention that "while product differentiation and advertising do result in considerable waste, their elimination would result in waste of a different sort."<sup>63</sup> In the absence of differentiation and advertising which inevitably accompanies it, waste is manifested in lack of incentive to improve quality or in expending resources in efforts to apply administrative quality controls. Advertising and differentiation, then, are instruments of competition the net effect of which may be to improve product quality and which only incidentally allow producers to avoid price competition.

But where advertising and differentiation exist price competition need not exist. Producers seek to build markets on promotion rather than price. Billions are spent to expand demand for this product or that. Some claim that the outcome of competition to build markets through advertising is expansion of all markets to some degree. Advertising, it is said, tends to increase the national income and to stimulate economic expansion by broadening total aggregate demand. The effect of advertising on the general level of economic activity derives from its effect upon aggregate demand and therein lies fruit for controversy.

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<sup>63</sup>Goldman, 348.

President Calvin Coolidge, addressing a 1926 gathering of the International Advertising Association, said, "Under the stimulation of advertising the country has gone from old hand methods of production which were so slow and laborious with high unit costs and low wages to our present great factory system and its mass production with the astonishing results of low unit costs and high wages. The pre-eminence of American industry, which has constantly brought about a reduction of costs, has come very largely through mass production. Mass production is only possible where there is mass demand. Mass demand has been created almost entirely through the development of advertising."<sup>64</sup> Advertising pictures the world of tomorrow to everyone and stimulates the demand, the aspirations, the drives which impel people to do the things which, taken together, combine to make the world of tomorrow a reality.<sup>65</sup> It is said to be the one great persuasive force in the building of high sales volume for industry and high wages and purchasing power for workers.<sup>66</sup> This, of course, implies creation of demand--where before advertising none existed. And this demand, to exert an influence upon the economy, must be effective, it must be expressed or expressible in the expenditure of money.

But since money does not grow on trees the means of expressing this newly created demand also must be an element of advertising's effect. There are two principal areas in which advertising may influence the ability of consumers to express demand; it may induce them to save less and consume more

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<sup>64</sup>Frank Presby, The History and Development of Advertising (Garden City: Doubleday, Durand Co., 1929) 598.

<sup>65</sup>American Roundtable Discussion of People's Capitalism: An Inquiry into Cultural Trends (New York: Advertising Council, 1957) 48.

<sup>66</sup>Paul Mazur, The Standards We Raise (New York: Harper and Row, 1953) 126.

out of their limited incomes or it may induce them to seek avenues of expanding the limits upon their incomes. In the former case consumers as a whole may consume proportionately more out of their incomes but the resulting decline in aggregate savings will adversely affect the ability of producers to expand their respective capacities to meet the newly created demand. The net effect may be only a rise in the general level of prices to absorb the extra demand. But if the paradox of thrift can also work in reverse, the effect of decreased individual savings may in the long run be positive on aggregate savings and therefore positive on capacity.<sup>67</sup>

The paradox of thrift bears on the second of the consumer's alternative means of increasing consumption, increasing his limited income. While an attempt to increase one's income will not automatically be successful, the effect of higher consumption out of present income may be helpful. Since one man's consumption is another's income, higher consumption out of one's given income will generate more income for another, out of which a portion will be saved. Therefore by saving less the individual is able in the short run to consume more out of fixed income and in the long run may be able to both save and consume more out of his share of the expanded national income. Though this analysis admits the possibility of a functional role for advertising in the expansion of national income it would not seem to justify the magnitude of the causative role ascribed to advertising in the foregoing paragraphs.

Textbook author George L. Bach minimizes the aggregate expansive effects of advertising. "When Chesterfield advertises, the main effect is to take customers away from Lucky Strike, Camels, and Old Golds. The ads may also

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<sup>67</sup>Paul Samuelson, *Economics: An Introductory Analysis*, 6th ed. (New York: McGraw Hill, 1964) 237.

induce new people to take up smoking or get present smokers to smoke more but these are probably not very important results. Given any level of total national spending, advertising that sells more cigarettes necessarily means less sales for someone else. This shift of demand will probably be away from other cigarette companies. But it may be away from candy makers, movies, or some industry only remotely in competition with cigarettes for the consumer's dollar."<sup>68</sup>

If this is the case two per cent of the gross national product, or the portion of it not justifiable as costs of distributing relevant market information, is being spent for nothing more productive than redistributing shares. "Imagine a monopolistically competitive milk industry in a good-sized city, with 15 milk companies of about equal size and no advertising. Company A begins an advertising campaign. It gets more customers by luring a few away from each of its competitors. Although A's costs are now higher, its profits are up because of increased volume, or perhaps because it now can raise its price since its milk is now differentiated as superior."<sup>69</sup> If, as Bach suggests, advertising does not contribute functionally to the expansion of national income, then the economies of scale through mass production, which advertising is said to induce, are the result of advertising's influence on concentration of supply among fewer large producers.

That portion of advertising which contains relevant market information is on more secure footing as a positive economic force. The expansive effect of information is more easily isolated than the effects of advertising, to

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<sup>68</sup>George Bach, *Economics: An Introduction to Analysis and Policy* (New York: Prentice-Hall, 1954) 359.

<sup>69</sup>Ibid.



include purely defensive advertising, taken as a whole. Concerning the absence or presence of relatively complete market knowledge, "The difference is that, if knowledge is imperfect, the size of the actual market, i.e., the number of actual buyers, is less than it would be otherwise, and the element of time is introduced into the process of competitive adjustments."<sup>70</sup> In Keynes' under-consumption model time lags in adjustment are of primary importance. Lags occur when income is earned but not immediately spent and when it is saved but not immediately invested. Money thus idled, is in effect, out of circulation. With more complete knowledge hesitation time between income and expenditure is reduced with the effect of increasing the money supply. Producers' expectations of profit are thereby brighter and investments will be undertaken more rapidly and in greater magnitude. The result is expanded national income.<sup>71</sup>

On balance the effect of advertising upon national income is at best a sort of economic lubricant contributing to, but hardly responsible for, general economic expansion, and at worst a superfluous leakage for economic resources whose chief effects are redistribution of shares and concentration of supply.

If a direct relationship exists between volume of advertising and magnitude of national income, it is apparent that advertising could function to damp or to prevent cyclical economic fluctuations. The stock of market knowledge is a perishable commodity and must be constantly replenished. New products, changing tastes, changing terms of sale and faulty retention contribute to the obsolescence of knowledge. If advertising is to act as an economic stabilizer

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<sup>70</sup>S.A. Ozga, "Imperfect Markets Through Lack of Knowledge," Quarterly Journal of Economics, LXXIV (February, 1960) 45.

<sup>71</sup>Borden, Economic Effects, 185.



its contribution to replenishing the stock of knowledge must be even-handed.<sup>72</sup> But in this role advertising has not fared well. Nicholas Kaldor contends that "As a possible method of ensuring an adequate and steady demand..., advertising comes out pretty badly."<sup>73</sup> Borden notes that none of the students of business cycle fluctuations have named advertising as an important factor, and moreover fluctuations occurred before advertising became an important factor in the economy.<sup>74</sup> Allowing for an effect of advertising, however minimal, on cyclic behavior, its influence has been destabilizing.<sup>75</sup>

"Advertising as used has tended to accentuate cyclical fluctuations because expenditures for advertising have varied directly with business activity ...It has been used most extensively in boom times and most lightly used in depressions. When thus employed it has tended to accentuate the swings of demand."<sup>76</sup> There is agreement that if advertising has any effect upon cyclic fluctuation it is not in favor of stability. There also seems to be agreement that advertising can exert only negligible influence upon cycles, in the first place, so discussion on this issue might at first glance seem irrelevant. But the degree of unanimity concerning the innocence of advertising as an important contributor to fluctuation casts serious doubt on the importance of the purported causal relationship of advertising to national income discussed previously.

The relationship of advertising to the broad spectrum of available choices for economic man in a free society is complex. By careful design the

<sup>72</sup>Telser, "Supply and Demand," 462.

<sup>73</sup>Nicholas Kaldor, "Economic Aspects of Advertising," Review of Economic Studies, XVIII (1949-1950) 11.

<sup>74</sup>Borden, Economic Effects, 865. <sup>75</sup>Kalder, 11.

<sup>76</sup>Borden, Economic Effects, 685.

consumer is made to feel the influence of advertising when he expresses demand. But advertising also affects his freedom of choice in subtler ways. He cannot express a market preference for or against advertising because he must buy it along with nearly everything else he purchases. Consumers' preferences as the ultimate criterion of economic activity, otherwise known as consumer sovereignty, cannot be invoked to justify expenditure on advertising. "Advertising, being a subsidized commodity, is not supplied in response to consumers' demands; the scale of expenditure on advertising--unlike the scale of expenditure on goods and services which are not subsidized--is not determined by the preferences of consumer, as registered through the price mechanism, but by purely extraneous considerations."<sup>77</sup> The nature of advertising as it is presently employed limits the range of intelligent choices open to the consumer. "The information in advertisements is generally biased, in that it concentrates on particular features to the exclusion of others; makes no mention of alternative sources of supply; and it attempts to influence the behavior of the consumer, not so much by enabling him to plan more intelligently, through giving more information, but by forcing a small amount of information through its sheer prominence to the foreground of his consciousness."<sup>78</sup> With his stock of knowledge as well as his perspective thus impaired the consumer is prevented from purchasing on the basis of freely determined choice.

But freedom of choice is enhanced by advertising, defenders claim, because the accompanying differentiation necessarily results in a broader range of products from which to choose. Whether such differentiation is significant and therefore relevant to consumer choice was discussed earlier.

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<sup>77</sup>Kalder, 4.

<sup>78</sup>Ibid. 5.

Freedom of choice is limited when advertising contributes to the concentration of supply in the hands of fewer producers, it is said, but this same concentration may enhance choices by permitting greater emphasis on research and subsequently improved new products.<sup>79</sup> On the other side of the same coin, "Given the fact of the economies of large scale production, an efficient production organization exploiting these economies necessarily involves restricting freedom of choice (i.e. the freedom of entry). Large scale advertising, at best, could be looked upon as one of the possible instruments for bringing about the necessary restriction on competition consistent with efficient production. In judging its social effects, however, it would be necessary to explore possible alternative methods of securing a similar degree of concentration in production which may not involve the same waste in the form of high selling costs."<sup>80</sup> If advertising impairs freedom of choice for producers and consumers its effect will be toward a different allocation of economic resources than would be the case in an environment devoid of advertising and its limiting effect on alternatives. But a different allocation is not necessarily a misallocation. If freedom of choice is a criterion upon which advertising's effect is to be judged, perhaps we err if we exclude a freedom to advertise or not to advertise from the relevant spectrum.

As advertising, in its attempt to mold and make predictable the vagaries of unpredictable demand and to increase knowledge or information, bears on freedom of choice, it also bears on value. Its relationship to value may be approached in two ways; value as manifested by pricing and value in terms of utility or satisfaction. While this is the same as to say that

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<sup>79</sup>Borden, Economic Effects, 178.

<sup>80</sup>Kalder, 26.

advertising affects value through both supply and demand, it provides convenient avenues of approach for discussion.

On the supply side the producer in employing advertising and aggressive selling techniques incurs costs which he must recover. These costs, reflected in producers' cost or supply curves, will influence pricing policy and in the long run bear on equilibrium prices arrived at in conjunction with other supply factors and demand. While this is relatively straightforward, advertising's effect on value through utility and consequently through demand is more tenuous. Costs to producers for advertising are incurred in an attempt to increase the marginal utility ascribed to their products by consumers.<sup>81</sup> By causing additional units of consumption to yield less-diminished amounts of utility than would otherwise be the case, advertising attempts to secure for an advertised product a larger market. "Thus sales promotion, advertisement, etc....are considered as qualifying the nature of the product, or if one prefers, as being another product sold to the consumer and enhancing the sales of the advertised product sold jointly with it."<sup>82</sup>

Dunn suggests that the mere fact of advertising may in some cases actually increase the value or utility of a product, as opposed to merely raising its price. For example, a Maidenform bra may yield more utility, have more value, than an identical unadvertised article because wearing it generates a psychic income derived from the worldly image it conjurs up as a result of having been heavily advertised. Of course the plain Jane is willing, as she must be, to pay a premium for this shortcut to worldliness and glamor.<sup>83</sup> Martin Mayor states the utility creating effect of advertising in more positive terms. "Advertising, in addition to its purely informing function, adds a new value

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<sup>81</sup>Borden, Economic Effects, 163. <sup>82</sup>Triffin, 169n. <sup>83</sup>Dunn, 81.

to the existing values of the product."<sup>84</sup> The new value added by advertising will, if producers have analyzed correctly, be reflected in higher prices or sales volume sufficient to cover the cost of adding the value.

This attempt to extraneously manipulate values in the market draws charges of suppression of competition. "A major barrier to really competitive enterprise and efficient service to consumers is to be found in advertising--in national advertising especially, and in sales organizations which cover great national or regional areas."<sup>85</sup> Advertising's effects on competition through influence on choice, on market entry, on concentration of supply and on quality have been discussed previously. Its influence on price competition enters here. Advertisers, by manipulating values in the market, by generating brand loyalties, are able to avoid to an extent competition in price. Monopolistic advantages thus gained allow the producer to remain impervious to competitive assault through price. The result may be price rigidity and subsequent fleecing of consumers.

On the other hand, the competitive nature of advertising may of itself be sufficient rebuttal to this charge. Even in the absence of advertising there is no guarantee that concentration of supply would not occur, that impure forms of competition would vanish. Advertising as used is competition. If competition in advertising is deemed unbeneficial, perhaps competition in other forms, including price, is no more beneficial.<sup>86</sup>

From the point of view of the consumer and in terms of price alone, price competition is singularly virtuous. But the consumer's point of view

<sup>84</sup>Martin Meyers, Madison Avenue, U.S.A. (New York: Harper, 1958) 310.

<sup>85</sup>Henry Simons, Economic Policy for a Free Society (Chicago: University of Chicago Press, 1948) 95.

<sup>86</sup>Telser, "Advertising in Competition," 551.

is not the only point of view and by allowing himself to indulge brand loyalties the consumer has indicated that price is not a solitary consideration and has, in a sense, made his own bed.

Among the claimed beneficial effects of advertising is the opportunity it affords for the functioning of a free press dependent upon the private rather than the public domain for its livelihood. The costs of advertising are, in part, income for the press. Without commercial advertising the free dissemination of news and information would not be possible.<sup>87</sup> Kaldor, with respect to the role of the press in the area of market information, suggests a less beneficent role for advertising.

The value of information on commodities depends on its objectivity and impartiality. But information conforming to these qualities can be provided only if the source is financially independent of the products with which the information deals. The natural source of objective current information on commodities is the press, which already supplies current objective information on all other things. If commercial advertising in the press had not developed, the press would gradually have devoted more time or space to information on consumers' goods as an extension of its informing function much like they now supply information on drama, horse races or the stock exchange. "In the world of commodities the 'authors' write their own reviews; and because all this review-writing in turn provides subsidies to others, the professional review writers (the press) refrain from reviewing their productions at all.... The charge that can be made against advertising as a method of supplying market information is therefore not only that it fails to provide enough information or unbiased information, but that its development has indirectly

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<sup>87</sup>Sandage, 13.

led to the suppression of other channels of information about commodities; and that in consequence the public may actually be provided with less information than it would have obtained without it, at a much higher cost to the community."<sup>88</sup>

Members of the press are among the staunchest defenders of advertising and are prone to cite its economic benefits to society.<sup>89</sup> If the press performs so vital a service to society in disseminating advertising, it would seem an odd perception of its calling, which permits the press to extract pay from both the supplier and the consumer of advertising. The prevailing assumption of the press seems to be that without the subsidy of advertising, subscribers to press services would be unwilling to pay enough to cover costs of its production. The press, too, by implication, seems to doubt the marketable value of advertising.

#### SUMMARY AND CONCLUSIONS

Economics, the dismal science, has long neglected advertising, the happy art. Classical economists could have experienced little in their environment to induce serious contemplation on advertising, but advertising and intense selling techniques had long been employed before economists attempted rigorous study of its role as an economic institution. Chamberlin and Robinson, with the construction of a formal theory of imperfect or monopolistic competition, began, and Keynes immortalized, a newer, more realistic trend in economic theory toward greater emphasis on demand and consumption factors.

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<sup>88</sup>Kaldor, 5,6.

<sup>89</sup>See prominently displayed ads sponsored by Magazine Publishers' Association appearing currently in many general circulation magazines.



With more attention drawn to consumption and demand, advertising and its effects on these factors came in for more detailed analysis. Still, a single authoritative work integrating and systematizing advertising into the general economic framework is not available. What we are left with are tangential references to advertising by economic scholars and copious amounts of usually desultory approbation from advertising's cheering section. The subject of advertising's economic effects is ready-made for controversy.

The ethical side of the issue, wants versus needs in demand stimulation, is, like most ethical issues, hotly debated and defiant of resolution. More concrete debate is possible on the more strictly economic effects of advertising. The immediate objective of advertising is to stimulate demand for a product and therefore to increase sales and profits for the advertiser. The success of these efforts throughout the economy are said to allow for greater efficiency in production through economies of scale. These economies of scale result in lower prices which pass these economies on to the consumer. Self-service retailing and smaller manpower requirements for direct selling also reduce costs. Knowing what is available, where and in what kind of package, saves time and energy for the consumer. But advertising is not a free service. Producers must pay for it and in the end consumers must pay for it. They pay for it usually without the knowledge that they are doing so and the result is lack of a direct market test for advertising. The result, the critics claim, is excess supply of advertising.

If advertising were sold as a joint but differentiable commodity with its subject, a market test would avail itself but the transaction costs of doing business would be multiplied. The net result might be higher rather than lower prices to consumers. The magnitude of the excess supply is a function of the demand for advertising by producers who seek to maximize



profits and of the demand for advertising by consumers who, if they knew its price, would demand less of it. The excess supply implies waste which otherwise might be utilized in productive pursuits.

General product quality is said to be upgraded by the practice of advertising because it makes consumers aware of changes or improvements in commodities and producers must be alert to change and improvement and compete in this area if they are to enjoy continued patronage. The Soviet economy presents an example for comparison of product quality in the absence of differentiation and advertising. To insure quality the Soviets have substituted a system of administrative controls and incentives in lieu of advertising and competition. The costs of quality control in this manner, while not a precisely comparable measure to the costs of advertising as a tool of quality control, and the complexity of formulation and administration raise doubts as to its comparative advantage over advertising in this respect. The fact that the Soviets have lately turned to production marking and a form of advertising are evidence of their disenchantment with administered quality controls.

Advertising also influences the range of products available. Some say its effect in this respect is minimal because the differentiation is largely superficial and meaningless. Perhaps, more meaningful than horizontal differentiation in a range of products is vertical differentiation in successively improved versions of products. The drive for "selling points" may be in the static view relatively meaningless, but in the long view this drive, feeding or feeding upon advertising, spurs product research and results in broadening the product range with previously nonexistent products.

Advertising may result in increased sales and profits for a given advertiser, but an additional product unit bought from one producer may only

represent the loss of a sale for another producer. If advertising's effect is primarily to redistribute market shares the plaudits it receives as an aggregate economic stimulator are undeserved. Advertising cannot directly enable a consumer to purchase additional products. It may induce consumers to save less and consume more out of given incomes and thereby increase the costs to producers for expansion of capacity to supply the greater general demand. It may, therefore, simply induce higher prices. But spending is income in the cycle and expressed demand breeds income breeds demand. The spiral effect of lower percentage saving out of given income may, up to a point, generate larger income with the result that aggregate saving is increased. Under these circumstances larger aggregate demand can be met with sufficient capital formation to supply it.

If volume of advertising varies directly with level of national income, then cycles of business activity can be damped by employing advertising counter-cyclically. Advertising has not been employed in this manner--quite the opposite is true. But the ones who claim for advertising a significant role in building mass demand, and all that that implies, are the same ones who confess that advertising's influence on business cycles is not, and cannot be, significant.

Advertising is charged with limiting the range of economic choices open to men. Consumers cannot express a market choice for or against advertising. Monopolistic tendencies of advertising concentrate supply and impede free market entry. But to the extent that advertising and differentiation are complementary advertising enlarges consumer alternatives.

Advertising contributes to total supply costs and therefore to the supply side of price determination. On the demand side advertising may be considered a joint commodity or itself an instrument of adding value or utility

undifferentiable from the primary product. In either case if advertising is successful demand curves are moved to the right and made more inelastic. The monopolistic producer is more able to remain impervious to price competition.

The avoidance of price competition is sometimes regarded as economic iniquity, but consumers, by virtue of being consumers, possess potential power to force price competition upon producers however reluctant they may be.

The role of the press as the primary vehicle of advertising is ambiguous. Advertising is market information. Information is important for the economy and is a valuable commodity. But the press must extract a subsidy from the source of this valuable information because they fear, and perhaps justly so, that in its present form its value in the market is considerably less than they would lead us to believe.

Advertising is no unmixed blessing. Its influence is positive to society, to the extent that, with allowances for prejudice, its effects are what its defenders claim. Its influence is negative to the extent that it is utilized beyond the requirements of market information sufficient to produce the positive influence. Its influence is empirically indeterminable to the extent that ceteris paribus with respect to advertising is an operational impossibility.

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THE ECONOMICS OF ADVERTISING

by

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AN ABSTRACT OF A MASTER'S REPORT

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Advertising has merited scrutiny as an economic institution far longer than economists have seen fit to provide it. Classical economists were not witnesses to a general practice of advertising, but before it was recognized and theoretically treated, advertising had long been employed as a tool by entrepreneurs. Robinson and Chamberlin, with their formalized theories of monopolistic and imperfect competition, first recognized the functional role of advertising and selling costs. Demand factors, long neglected as dynamic elements, began to draw more attention from analysts. Unanimity does not characterize the general view of advertising's effects.

The issues involved may be classified as ethical or economic. The chief ethical issue involves the potential for advertising to induce consumers to consume objects of mere want rather than genuine need. Whether this bodes good or evil for society is a question of subjective judgment. But if advertising is successful several economic issues evolve. Advertising can contribute to economies of scale to the extent that it stimulates mass demand. Advertising represents costs to the producer and are indicated in prices for advertised products, but consumers are generally unaware of the magnitude of their advertising bill. If consumers were able to accept or reject the advertising bill at the point of sale of the advertised product, less advertising might be employed.

Advertising, by stressing differential features of products, tends to promote quality improvement as a form of competition. The Soviet experience without advertising supports this contention. If advertising is able to accomplish more than a mere redistribution of shares, it must be able to affect aggregate ability to spend. It may accomplish this by decreasing aggregate savings in a static sense and by increasing aggregate income in a dynamic sense. Business cycles are not significantly affected by advertising.

Consumer choice is enhanced by advertising to the extent that it promotes broader range in products and it is limited to the extent that advertising tends to concentrate supply among few large producers. If effective, advertising permits producers to carve out little monopolies for themselves and thereby to avoid direct price competition. Price competition, however, might be forced upon advertisers if consumers would consume on the basis of price differentials alone.

The press, as the primary vehicle of advertising, plays an ambiguous role. It extracts a subsidy from advertisers so that it may sell its product, of which advertising is a major constituent, at a price which consumers seem willing to pay. In so doing, the press places itself in the ranks of those who doubt that the present scale of advertising would survive the market test.

That amount of advertising which provides relevant market information is justifiable economically under the criterion of efficiency, but at the point at which it becomes merely redundant and defensively competitive, its effect is disfunctional under the criterion of efficiency.